

## Message Text

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ACTION EA-09

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-01

INR-07 NSAE-00 USIA-15 TRSE-00 XMB-04 OPIC-06

SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04

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R 050607Z AUG 77

FM AMEMBASSY SEOUL

TO SECSTATE WASHDC 5551

INFO AMCONSUL HONG KONG

UNCLAS SECTION 1 OF 2 SEOUL 6568

HONG KONG FOR REGFINATT

E.O. 11652: N/A

TAGS: EFIN, ETRD, EGEN, KS

SUBJECT: KOREAN GOVERNMENT TIGHTENS UP FURTHER ON BORROWING FROM  
ABROAD

SUMMARY - UNDER NEW REGULATIONS WHICH TOOK EFFECT AUGUST 1, THE ECONOMIC PLANNING BOARD (EPB) HAS TAKEN STEPS TO FURTHER RESTRICT THE INFLOW OF FOREIGN CURRENCY LOANS--PARTICULARLY SMALL LOANS--FROM ABROAD, AND TO ENSURE THAT TERMS AND CONDITIONS NEGOTIATED BY KOREAN BORROWERS ARE FAVORABLE FROM KOREAN POINT OF VIEW. THESE MEASURES MAY BE REGARDED AS A CONTINUATION OF ROKG EFFORTS OVER PAST YEAR TO CUT DOWN ON INFLATIONARY GROWTH OF MONEY SUPPLY BY REDUCING INFLOW OF UNNEEDED FOREIGN CAPITAL. END SUMMARY.

1. AS ADDRESSEES AWARE, ALL PUBLIC AND COMMERCIAL LONG/MEDIUM TERM FOREIGN CURRENCY LOANS FROM ABROAD (AS DISTINCT FROM FX LOANS FROM RESERVES OF DOMESTIC INSTITUTIONS) MUST, WITH CERTAIN EXCEPTIONS, BE APPROVED BY EPB UNDER THE FOREIGN CAPITAL INDUCEMENT LAW OF 1973. NEW REGULATIONS, IN EFFECT, SERVE NOTICE TO KOREAN BORROWERS THAT IN FUTURE LOAN APPLICATIONS  
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WILL BE APPROVED ONLY IF THEY MEET CERTAIN CONDITIONS. BROADLY SPEAKING, EPB WILL BE LONGER CONSIDER LOAN APPLICATIONS AMOUNTING TO LESS THAN \$3 MILLION PER PROJECT; ON WHICH INTEREST RATE IS MORE THAN TWO PERCENT OVER SIX-MONTH LIBOR (LONDON INTERBANK OFFERED RATE); AND ON WHICH COMMISSION FEES (NOT INCLUDING COMMITMENT FEE) ARE IN EXCESS OF 1.5 PCT. FURTHER, EPB HAS SET MINIMUM MATURITIES OF VARYING LENGTH DEPENDING ON PURPOSE OF LOAN.

2. IN THE CASE OF LOANS FOR THE IMPORT OF CAPITAL GOODS, NEW REGULATIONS IDENTIFY FOLLOWING QUOTE PRIORITY SECTORS UNQUOTE: HEAVY/CHEMICAL INDUSTRIES; DEVELOPMENT OF POWER RESOURCES; EXPORT INDUSTRIES; TOURIST HOTELS; AND QUOTE OTHER IMPORTANT INDUSTRIES UNQUOTE. FOR SUCH LOANS, AMOUNT MUST BE MORE THAN \$3 MILLION (WITH THE IMPORTANT EXCEPTION THAT FOREIGN-INVESTED FIRMS ARE EXEMPT FROM THIS REQUIREMENT); DOWN PAYMENT MUST COME FROM BORROWER'S OWN RESOURCES OR DOMESTICALLY-OBTAINED FX LOAN; MATURITY MUST BE SEVEN YEARS OR OVER, INCLUDING GRACE PERIOD (WITH THE EXCEPTION OF CERTAIN GOODS, E.G., USED VESSELS, WHICH ARE NOT NORMALLY FINANCED ON LONG-TERM BASIS); INTEREST RATE MUST BE NO MORE THAN 2 PCT OVER SIX MONTH LIBOR; AND COMMISSION FEE, NOT INCLUDING COMMITMENT FEE, MUST BE 1.5 PCT OR LESS.

3. CASH LOANS, I.E., LOANS NOT ACCOMPANIED BY IMPORT OF EQUIPMENT, WILL BE BANNED IN PRINCIPLE. HOWEVER, EXCEPTIONS MAY BE MADE IN FOLLOWING CASES: AS DOWN PAYMENT FOR CAPITAL EQUIPMENT, WHEN MOBILIZATION OF DOMESTIC FX IS DIFFICULT; TO PAY ROYALTY FEES; TO REFINANCE PREVIOUS LOANS MADE ON UNFAVORABLE TERMS; AND TO RAISE FUNDS, WHEN SUCH FUNDS NOT AVAILABLE DOMESTICALLY, FOR THE PROCUREMENT OF DOMESTIC MATERIAL AND EQUIPMENT FOR GOVERNMENT-INVESTED PROJECTS; HEAVY CHEMICAL/ INDUSTRIAL PROJECTS; POWER RESOURCE DEVELOPMENT PROJECTS, AND TOURIST HOTELS. AGAIN, SUCH LOANS MUST AMOUNT TO \$3 MILLION OR UNCLASSIFIED

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MORE, WITH INTEREST RATE NO MORE THAN 2 PCT OVER LIBOR, AND COMMISSION FEES NO MORE THAN 1.5 PCT. MINIMUM MATURITY IN THIS CASE IF FIVE YEARS.

4. FINALLY, COMMODITY (RAW MATERIAL) LOANS WILL ALSO BE BANNED IN PRINCIPLE, BUT WITH FOLLOWING EXCEPTIONS: WHEN DOMESTIC FX LOANS, OR IMPORT ON DEFERRED PAYMENT BASIS IS IMPOSSIBLE OR DIFFICULT; WHEN PURCHASE OF RAW MATERIALS JUSTIFIED FOR PURPOSES OF STOCKPILING IN ORDER TO MODERATE PRICE INSTABILITY; FOR IMPORT OF RAW MATERIALS ON A LONG-TERM SUPPLY CONTRACT; FOR MAJOR DEFENSE PURCHASES; AND FOR PURCHASES OF COMMODITIES QUOTE IMPORTANT TO THE LIFE OF THE PEOPLE UNQUOTE. REQUIRED TERMS AND CONDITIONS SAME AS FOR OTHER TYPES OF LOAN, EXCEPT THAT MINIMUM MATURITY IS FROM THREE AND ONE HALF TO FIVE YEARS.

5. MANY OF THE RESTRICTIONS IMPOSED BY THE NEW REGULATIONS ARE NOT NEW. WHAT IS NEW IS THE \$3 MILLION MINIMUM LOAN SIZE, AND PURPOSE APPEARS TO BE TO CHANNEL SMALL-TIME KOREAN BORROWERS AWAY FROM INTERNATIONAL MONEY MARKETS, TOWARDS DOMESTIC LENDING INSTITUTIONS WHERE FX IS AVAILABLE FOR SMALL LOANS. EXPLAINING THE REASONING BEHIND THE NEW MEASURES, EPB SOURCES POINT TO A NUMBER OF CONSIDERATIONS. FIRST, THEY

HOPE, BY CUTTING DOWN ON THE FLOW OF SMALL-SCALE OFFSHORE LOANS, TO LIMIT THE INFLATIONARY GROWTH OF KOREA'S MONEY SUPPLY--WHICH THAS BEEN FUELED LARGELY BY FOREIGN CAPITAL INFLOWS. SECOND, EPB IS CONCERNED THAT SMALL KOREAN BUSINESSMEN, INEXPERIENCED IN INTERNATIONAL MONEY MARKETS, OFTEN SETTLE FOR LESS THAN FAVORABLE LOAN TERMS. IN FUTURE, SUCH BUSINESSMEN WILL BE ENCOURAGED TO OBTAIN FOREIGN CURRENCY LOANS FROM DOMESTIC INSTITUTIONS SUCH AS KOREAN DEVELOPMENT BANK, MEDIUM INDUSTRY BANK, AND AUTHORIZED COMMERCIAL BANKS, ALL OF WHOM HAVE AMPLE FOREIGN CURRENCY HOLDINGS--OBTAINABLE AT FAVORABLE RATES--TO MEET SMALL LOAN REQUIREMENTS. A COROLLARY BENEFIT OF CHANNELLING THIS BUSINESS TOWARDS DOMESTIC INSTITUTIONS, ACCORDING TO EPB SOURCES, WILL BE TO INDUCE LOCAL COMMERCIAL BANKS TO BECOME MORE ACTIVE IN THIS FIELD. FINALLY, EPB NOTES UNCLASSIFIED

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THAT PROCESSING APPROVAL FOR SMALL OFFSHORE LOANS, PARTICULARLY WHEN POORLY NEGOTIATED BY SMALL-SCALE KOREAN BORROWERS, INVOLVES A GREAT DEAL OF TIME-CONSUMING RED TAPE. UNDER NEW REGULATIONS, EPB WILL BE RELIEVED OF THIS TASK AND FREE TO CONCENTRATE ITS ATTENTION ON LARGER LOANS.

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INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-01  
INR-07 NSAE-00 USIA-15 TRSE-00 XMB-04 OPIC-06  
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R 050607Z AUG 77  
FM AMEMBASSY SEOUL  
TO SECSTATE WASHDC 5552  
INFO AMCONSUL HONG KONG

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HONG KONG FOR REGFINATT

6. NEW REGULATIONS WILL NOT RPT NOT HAVE SIGNIFICANT IMPACT

ON OPERATIONS OF U.S. BRANCH BANKS IN KOREA. A LARGE PERCENTAGE OF THEIR FOREIGN CURRENCY LENDING IS SO-CALLED EPL (EXPORT PROMOTION LAW) LENDING, UNDER WHICH THEY HAVE BLANKET APPROVAL FROM EPB TO MAKE CERTAIN LOANS IN SUPPORT OF KOREAN EXPORTS. THIS CATEGORY OF LENDING WILL NOT BE AFFECTED BY NEW REGULATIONS. IN THE CASE OF OFFSHORE LOANS WHICH DO HAVE TO BE APPROVED BY EPB, BRANCH BANKS ALREADY TEND TO PURSUE A POLICY OF CONFINING THEIR ACTIVITIES TO LARGER LOANS--WELL OVER \$3 MILLION, GENERALLY--IN PART BECAUSE TIME-CONSUMING EPB APPROVAL PROCEDURE HAS MADE PURSUIT OF SMALL LOAN BUSINESS LESS WORTHWHILE.

7. COMMENT: NEW MEASURES PROVIDE YET ANOTHER INDICATION THAT KOREANS, RIDING THE CREST OF A FAVORABLE BALANCE OF PAYMENTS POSITION, CAN NOW AFFORD TO BE MORE SELECTIVE IN APPROVING FOREIGN LOANS; AND THAT THEIR CONCERN IS FOCUSING LESS ON BALANCE OF PAYMENTS THESE DAYS THAN ON LIMITING INFLATIONARY EXPANSION OF THE MONEY SUPPLY.  
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